No. 15,619

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY, a corporation,

Appellant,

vs.

MARY TROUTFELT COHEN,

Appellee,

and

MARY TROUTFELT COHEN,

Appellant,

vs.

JOHN HANCOCK MUTUAL LIFE INSURANCE COMPANY, a corporation,

Appellee.

APPELLANT'S OPENING BRIEF.

HENRY C. CLAUSEN,
KEESLING & KEESLING,
WILLIAM H. KEESLING,
315 Montgomery Street,
San Francisco 4, California,
Attorneys for Appellant John Hancock Mutual Life Insurance Company.

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APPELLANT'S OPENING BRIEF.

JURISDICTIONAL STATEMENT.

This action to collect the proceeds on a family income rider to a life insurance policy was commenced against appellant in the Superior Court of the State of California in and for the City and County of San Francisco. (R. 8.) Appellant petitioned for removal to the United States District Court for the Northern

District of California, Southern Division (R. 6), and the action was removed to that Court pursuant to the provisions of Title 28, United States Code, §§ 1332, 1441, in that it is a civil action wherein the matter in controversy exceeds the sum or value of $3,000.00, exclusive of interests and costs, and is between citizens of different states. The case was tried without a jury before Judge Carter, whose Memorandum Opinion (R. 75) is reported at .....F. Supp. ..... Judgment for plaintiff was entered March 20, 1957. (R. 107.) A notice of appeal was filed March 27, 1957. (R. 109.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1291.

STATEMENT OF THE CASE.

The plaintiff, Mary Troutfelt Cohen, brought suit against the John Hancock Mutual Life Insurance Company to recover damages for an alleged breach of the contract of insurance which had been taken out by her now-deceased husband. (R. 8.) Plaintiff alleged that under the terms of that life insurance contract, and specifically under the provisions of the family income supplemental provision thereto, the defendant was obligated to pay to her a monthly sum of fifty dollars after the death of insured for a period extending for twenty years subsequent to the date of issuance of the policy. (R. 10.) Plaintiff next alleged that the defendant fully performed under the policy of insurance up to a time 15 years from the date of issuance of the policy, at which time defendant tendered the final payment provided for in the policy

but refused to continue the monthly annuity for five more years. (R. 10-11.)

Defendant insurance company filed an answer and counterclaim, admitting the existence of an insurance contract and alleging a willingness to perform its obligations under that contract, but denying that the contract that was entered into between itself and insured called for the monthly annuity of fifty dollars to extend for any longer period than fifteen years from the date of issuance of the policy. (R. 18.) It is the contention of the defendant that the true agreement between the contracting parties is shown by the application for the insurance policy and other data and correspondence relevant to this policy, and that the written copy of the contract which was sent to the insured did not contain the agreement of the contracting parties, due to an accident or error in transcribing that agreement. (R. 23.) Defendant set up these allegations both by way of defense to plaintiff's cause of action and as the basis for affirmative relief, namely reformation of the contract.

The Court below rendered judgment for plaintiff, denying any relief to defendant on its counterclaim. The basis of this decision was a ruling that the agreement between the parties was contained in the written copy of the contract in the possession of the plaintiff. The Court relied also on the statute of limitations in finding against defendant insurance company.

The evidence at the trial was as follows:

In the early part of 1939, one Martin E. Troutfelt applied for and received a policy of insurance num-

bered 3171136 which provided for payment of premiums over a period of twenty years. (R. 158.) Included in this policy was a supplemental family income provision, which required an extra premium for fifteen years and provided an annuity to the beneficiary for a period of twenty years. (R. 164.)

Shortly thereafter, Martin E. Troutfelt made application to convert this policy, stating therein that he desired to change the twenty payment life to a fifteen year endowment. The application also requested a family income rider, but did not specify the period of time for which the rider was desired. (R. 170.) Additional correspondence was required to fill in this missing data, so another form was sent to the applicant for his signature. On this form the company had typed in the presumed data, namely ten years as the length of time the extra premium would be payable, and 15 years as the length of time the monthly annuity would be paid. (R. 170, 172.) This form was signed by Troutfelt and returned to the company. (R. 170.) On the basis of this form and the application previously received, the company then issued a new policy of insurance to Troutfelt, that being the policy at issue in the present case. (R. 173.) But though the application called for a fifteen year term, *and though the premium charged for the rider was the correct premium for a fifteen year term* (R. 165-166) the word "twenty" was inserted by mistake of the scrivener instead of the word "fifteen." (R. 102.)

The evidence also shows that defendant insurance company did not actually discover this mistake until

the plaintiff refused to accept its tender of the final payment. The insurance company did not keep a carbon copy of the filled-in policy or use the filled-in policy in its processing of the claim. (R. 178.) Instead, the company uses the application forms signed by the insured. (R. 178.) The company had possession of the written policy on only two occasions, the first being when the policy was originally made out and the blanks filled in (R. 173), the second being when the insured died and the policy was sent in to the company to be processed for payment. (R. 71.) But that processing, as shown above, was done on the basis of the company's records, which nowhere contain a copy of the policy as filled in. (R. 178.) The only purpose in requiring the original policy to be sent to the company is so that an endorsement may be stamped thereon, giving the beneficiary a record of the fact of processing.

The record is devoid of any evidence of negligence on the part of the company unless it is found in the facts set out above. The record similarly contains no indication of any injury to the plaintiff in the case, nor of any detrimental reliance or change of position. The record shows that there was no additional consideration running to the company which could support a new promise to pay. Finally, there is no evidence that the insured's intentions regarding the contract were at any time altered from his intention as clearly expressed in the application for insurance signed by him, no evidence that he did not continue in his original intentions and impressions regarding this contract up till the date of his death.

Nevertheless, the Court below found that the terms of the contract between the company and the insured are those found in the written policy. The Court also found that there had been a scrivener's mistake, but ruled that it was merely a unilateral mistake, since insured neither knew nor suspected, nor reasonably could or should have known or suspected that a mistake had occurred. Finally, it was ruled that the insurance company was negligent in not discovering the mistake on each of the occasions when it had possession of the original policy. From the facts as thus determined, the Court then held that defendant did not have a right to relief, and that even should such right have once existed, it was now barred by the statute of limitations. The Court then held defendant in breach of its contract, applied the doctrine of anticipatory breach, and rendered judgment for plaintiff in the sum of $8000.00 plus various sums of interest. Defendant prosecutes this appeal from that judgment.

QUESTIONS PRESENTED.

1. Whether the lower Court did not err in applying the doctrine of anticipatory breach to this contract which involved installment payments of money.

2. Whether the lower Court did not err in failing to apply and give controlling effect to the law of the State of New Mexico in adjudicating the substantive issues of this case.

3. Whether the lower Court did not err in its construction of the terms and obligations of the contract

as a matter of law; whether the only construction permissible under the evidence is not one that precludes a finding that defendant breached its contract.

4. Whether under the facts of this case, and the applicable law, defendant is not entitled to reformation of the contract as written to accord with the contract as mutually intended.

5. Whether under the facts of this case and the applicable law, defendant does not have a complete defense to plaintiff's suit for breach of contract.

6. Whether the lower Court did not err in finding that defendant's counterclaim for reformation was barred by the statute of limitations, in that it misinterpreted the legal requirements for starting the running of the period of limitations.

7. Whether the lower Court did not err in finding that defendant's defense of mistake was barred by the statute of limitations.

SPECIFICATION OF ERRORS.

1. The Trial Court erred in finding that by the terms of the contract between this appellant and the insured the said insured was to pay premiums for 15 years from the effective date thereof.

2. The Trial Court erred in finding that by the terms of said contract this appellant agreed to make monthly payments of $50.00 per month to plaintiff for a period extending to and including February 1, 1959.

3. The Trial Court erred in finding that the said insured did not know nor suspect, nor reasonably could or should have known or suspected any mistake in writing the premium payment term in the supplementary provision for family income as 15 (instead of 10) years, or in writing the income payment period therein as 20 (instead of 15) years, and in finding that such a mistake was the unilateral mistake of defendant alone.

4. The Trial Court erred in finding that in the exercise of ordinary care or reasonable diligence, this appellant could have discovered its alleged mistake in 1939, or in 1945.

5. The Trial Court erred in finding that this appellant discovered its alleged mistake in 1939 or at the latest on July 26, 1945.

6. The Trial Court erred in finding and concluding that this appellant committed an anticipatory breach of the said contract on or about May 13, 1954.

7. The Trial Court erred in awarding judgment to respondent in the sum of $8,000.00, together with interest at 7% per annum until the date of entry of judgment on installments of $50.00 dating from March 1, 1954.

8. The Trial Court did not err in failing to award to respondent damages on account of this appellant's alleged breach of the following alleged warranty:

> "It is not necessary to employ any firm or person to collect the proceeds of this policy."

ARGUMENT.

I. UNDER NO CIRCUMSTANCES WAS THE TRIAL COURT JUSTIFIED IN APPLYING THE DOCTRINE OF ANTICIPATORY BREACH. THE DOCTRINE OF ANTICIPATORY BREACH IS NOT APPLICABLE WHERE THE CONTRACT HAS BECOME UNILATERAL IN PERFORMANCE, SO THAT ALL THAT REMAINS TO BE PERFORMED IS INSTALLMENT PAYMENTS OF MONEY.

This proposition is too well established to require more than a brief citation of authority. See, for example, *Restatement of Contracts,* § 318, Comment (e); 12 Cal. Jur. 2d, Contracts § 250. The subsequent portions of this brief conclusively show that plaintiff is not entitled to any recovery at all. But, in any event, the Court had no authority to award plaintiff any more than the amount of the installments already due and owing.

This case provides a classic example of the type of case in which anticipatory breach is inapplicable. The only performance that remains under this contract is the payment by the insurance company of certain sums of money, to be paid in installments on specified dates. No further performance is required of the insured or of plaintiff. No further conditions must be met by the insured or by plaintiff. Plaintiff is fully protected by giving her exactly what was bargained for, *i.e.,* installment payments of money. She can recover now only those installments now due.

This was the holding of *Cobb v. Pacific Mutual Life Ins. Co.,* 4 Cal. 2d 565, 51 P. 2d 84, an insurance case in which this question was the sole issue raised on appeal. The Court exhaustively considered the ques-

tion, and an extensive list of authorities can be found in the opinion. The conclusion was that anticipatory breach may not apply to installment payments of money. The Court below therefore erred prejudicially in including in its judgment those installments which were not yet due or owing to plaintiff.

II. THE LAW OF THE STATE OF NEW MEXICO IS THE CONTROLLING BODY OF LAW IN ADJUDICATING THE MERITS OF THIS CASE; AND THE COURT BELOW ERRED IN FAILING TO APPLY IT.

Before proceeding to the substantive law of the case, it becomes necessary to determine which body of law will be controlling. This case is within the jurisdiction of the federal Courts only by virtue of diversity of citizenship. The questions at issue pertain to matters of state law. Under these circumstances, the famous *Erie* doctrine requires the federal Court to apply on all matters of substance the law of the state in which the federal Court is sitting. Thus, the law of the state of California will govern this dispute.

But there is another Conflicts problem present in this case. The transaction which is the basis of suit is not local to California. Thus, the California Courts would themselves refer to the law of another jurisdiction to decide the substantive issues presented. The federal Court under the *Erie* doctrine is governed by this California conflicts rule. See, e.g., *Griffin v. McCoach,* 313 U.S. 498, 61 S. Ct. 1023, 85 L. Ed. 1481; *Zellmer v. Acme Brewing Co.,* 184 Fed. 2d 940 (9th Cir. 1950).

California law is clear that under the facts of this case, the law of New Mexico will be applied to determine the rights of the parties to this dispute. The California rule is that contracts are governed by the law of the place of performance, if that place is ascertainable, and otherwise, by the law of the place of formation. The rule is incorporated in the California Civil Code, § 1646:

> "A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made."

See also, *Pregresso S.S. Co. v. St. Paul etc. Ins. Co.,* 146 Cal. 279, 79 Pac. 967; *Pratt v. Dittmer,* 51 Cal. App. 512, 197 Pac. 365; *Flittner v. Equitable Life Assur. Soc.,* 30 Cal. App. 209, 157 Pac. 630.

The facts show that the application for Policy No. 3223099 was made in New Mexico (R. 173), that premiums were paid from there (R. 173), that the policy was delivered there (R. 173-174), and that the contract presumably was to be performed there by payment to the insured or his beneficiary. Under this set of facts, New Mexico is both the place of performance and the place of formation of the contract at bar. It is inescapable, therefore, that the law of New Mexico will govern this dispute.

New Mexico case law is rather sparse, and yet we are fortunate to have at least one New Mexico case on each of the three heads under which appellant seeks relief. And it will be seen that in each area,

construction of the terms of a contract, mistake as a ground for reformation and mistake as a defense to a suit, the New Mexico law as revealed by these cases, both in their holdings and their language, is unequivocally in favor of appellant's positions. The Court below erred in ignoring the controlling effect of these New Mexico cases.

III. THE ONLY PROPER CONSTRUCTION OF THE CONTRACT HERE WOULD PRECLUDE THE ERRONEOUS FINDING THAT APPELLANT BREACHED ITS CONTRACT.

Appellant's first contention is that before any talk of breach can be considered proper, it is first necessary to construe the contract and define the obligations of the parties under the contract, and that when this has been done it will be seen that appellant has tendered full performance of its contract obligations. In so construing the contract, it is essential to regard the contract as a whole, harmonizing its parts and noting the interplay among them. This is a familiar process, arising to some extent in every suit upon a contract. It has nothing to do with the equitable right to reformation or with the doctrines involving mistake.

The contract of insurance in the present case is embodied in a writing, thus greatly simplifying our task. But it is important to notice that *one part of this writing is the application for insurance which was made out by the insured* and processed by the insurer. The first page of the formal policy explicitly states as follows:

> This insurance is granted in consideration of the application herefor, a copy of which is attached hereto and made a part of this contract . . .

Such a provision is clearly sufficient to incorporate all of the terms of the application into the formal contract. The complete contract thus contains duplicating provisions in many respects. Among those provisions which are duplicated are the crucial ones at issue here, relating to length of time the rider should be effective. The contract in one place gives that time as "20 years", but in another place recites that time as "15 years." Here, then, is an ambiguity or inconsistency apparent on the face of the instrument. Where such ambiguity exists, the Court has a preliminary job of construction. To aid in this construction, parol evidence and the history of the transaction and any other relevant circumstances should be examined. This is the rule announced in the New Mexico case of *Franciscan Hotel Co. v. Albuquerque Hotel Co.,* 24 P.2d 718 (New Mexico). The contract in that case involved a lease of hotel property. Plaintiff requested reformation, or in the alternative, construction and interpretation of the contract as written. The Court found that construction was necessary, though the ambiguity in that case was not nearly so striking as the one involved here. In resolving the ambiguity in favor of plaintiff, the Court relied heavily upon the prior dealings between the parties. The goal of course was to reach the real intent of the parties. So here, our object is to discover the real intent of the insurer and the insured. Here too, the prior dealings

between the parties are revealing of that intention. The history of the transaction shows that a 15 year term was the one intended by both parties. The history of the transaction also discloses how the figure "20" came to appear upon the document; it had its source in a prior 20 year contract that was abandoned and superseded by the present contract.

But the proof which removes all doubt as to intention is the application for insurance itself. New Mexico law is clear on the importance of the application in a case like the present. In *Bass v. Occidental Life Ins. Co.,* 142 Pac. 798 (New Mexico) the Court was presented with a formal policy of accident insurance and the application for that policy. The matter at issue was the coverage provided by the insurance contract. The Court ruled that the application and the policy must be construed together. The application and the policy each limit and modify the other. This is so even though the two writings were executed on different dates. The Court observed as follows (p. 800):

> Can it be said that the applicant for insurance is not to be bound by the express terms of the instrument signed by him, which was in effect his application for insurance. We think not.

The important significance to be attributed to the application for issuance is further illustrated in *Points v. Wills,* 97 P.2d 374 (New Mexico).

The precise issue raised here was raised and answered in *Castellina v. Vaughan,* 11 S.E.2d 536 (W. Va. 1940). In its syllabus, the Court said:

> In construing insurance contracts, courts should give effect to the intentions of the parties. When a policy incorporates the application, but through clerical inadvertence departs from it, the policy does not reflect that intention and the application controls.

The Court below erred in ignoring the intention of the parties, an intention indisputably disclosed by the application for insurance, the business policies of the insurer, and the entire history of the transaction. The only proper construction of the contract must be that a 15 year rider was intended. And this Court should so hold. No evidence save the item that gave rise to the ambiguity itself indicates otherwise.

IV. THE EVIDENCE IN THIS CASE SHOWS AS A MATTER OF LAW, THAT DEFENDANT WAS ENTITLED TO REFORMATION.

Appellant's second contention is that a mistake was made in the process of reducing this contract to writing; that while the terms of the policy were being copied onto the formal policy form used by the company to be delivered to the insured, the scrivener mistakenly copied the numbers "15" and "20" instead of the proper and agreed upon numbers, "10" and '15". The Court below found that such a mistake did in fact occur. (R. 76.) But the Court denied the company's counterclaim for reformation upon the ground that such relief requires "mutual" mistake, while in the present case there was only a "unilateral" mistake. The Court observed as follows (R. 79):

> . . . defendant has failed to prove mutual mistake; defendant has not shown that the insured knew or should have known of defendant's mistake.

In one respect only is this mistake unilateral; namely, in that it was an employee of the company that made the error. But this is of absolutely no consequence under the law of New Mexico which must be applied here. There are two distinct doctrines comprehended under the title of "reformation", and the same terminology is employed in discussing both of them. But the requirements of each are vastly different. In this case, the defendant was relying upon and entitled to invoke one of these doctrines, but the plaintiff and the lower Court *were discussing the other*. A look at the applicable New Mexico cases will clear up the ambiguity.

The doctrine most frequently employed involves a mistake in the *formation* of a contract. One of the parties has made a mistake, so that the agreement that is reached is not an agreement that he would have voluntarily made on these terms. In such a case, that party can get relief, but he must first show that the other party shared his mistake or was aware of it. If such a showing is made, the mistake is denominated "mutual," otherwise it is denominated "unilateral." This is not the ground on which reformation is sought here.

The second doctrine of reformation involves a mistake in the transcription of an agreement. In this case, the parties have reached an agreement—a meet-

ing of the minds—in which there is no mistake. Then, while the agreement is being reduced to a formal writing, an error is made. Whether this type of mistake be referred to as mutual or as unilateral, reformation will be granted upon a showing that a prior agreement was reached and that the writing does not reflect the agreement. Appellant's right to reformation here falls under this head.

The difference between the two doctrines is concisely pointed out in the New Mexico case of *Points v. Wills,* 97 P.2d 374, 378 (New Mexico):

> Where there is no mistake as to the terms of an agreement but through a mistake of the scrivener or by any other inadvertence in reducing it to writing the instrument does not express the agreement actually made, it may be reformed by the Court; it is only where an action is to reform the agreement itself that it is necessary to allege in the pleading and to prove on the trial that the mistake was mutual.

Thus it is irrelevant whether insured knew or should have known of the error in his copy of the policy. In all probability he did not notice that any change had been made. The only important question to ask is whether both parties had come to an agreement prior to the time the scrivener's error was committed. As stated in *Dearborn v. Niagara Fire Ins. Co.,* 125 Pac. 606, 608 (New Mexico), a case involving a similar reformation issue, "it is not material what language the parties used to express their mutual intent, but the question is whether their minds actually met upon a common understanding or mutual intent."

That case quoted from *Snell v. Insurance Co.,* 98 U.S. 85, as follows (p. 608):

> "The written agreement did not effect that which the parties intended. That a court of equity can afford relief in such a case is, we think, well settled by the authorities."

The case of *Cleveland v. Bateman,* 158 Pac. 648 (New Mexico), another reformation case, refers to a requirement that the mistake be mutual, but makes plain that by "mutual" it means no more than that there must have been a prior meeting of the minds and a later mistake in reducing that agreement to writing.

Do the facts in the present case show such a meeting of the minds to have existed? They not only do so, but they leave no room for any other position. The facts relevant to the state of mind of the insured are indisputable. We have his application, signed by him, and under circumstances that would call these disputed terms strongly to his attention. For the importance of the insured's application in determining his state of mind, see *Points v. Wells, supra; Bass v. Occidental Life Ins., supra.* The manifestations of the state of mind of the insurance company likewise leave no room for doubt. The company filled in the blanks on the application before sending it to the insured. (R. 172.) Furthermore, competent testimony has demonstrated that the company had a firm policy in regard to such terms in the policy, so that it would not issue a 20 year rider with a 15 year policy, nor would it issue a rider that did not in all respects conform to

the application. (R. 175-177, 186.) Thus we have clear and complete proof that there was an agreement, a meeting of the minds, and that both the insured and the insurer intended the contract to call for a rider with a term of 15 years. Subsequently, the scrivener mistakenly inserted the number "20" for the number "15". Therefore, "the written agreement did not effect that which the parties intended. That a Court of equity can afford relief in such a case is well settled by the authorities."

Plaintiff in the Court below objected to reformation on the theory that no enforceable contract existed prior to the receipt by the insured of the formal printed contract. But plaintiff's reasoning shows up its own fallacy. For it would preclude reformation ever being granted on an insurance contract or any other unilateral contract. Such is not the law. This precise type of argument was raised and devastated by the Court in *Columbian Nat. Life Ins. Co. v. Black,* 35 F.2d 571 (10th Cir. 1929). But we do not need to go so far afield to demonstrate that the "agreement" or meeting of the minds which is required for reformation does not have to be a valid, enforecable contract. The New Mexico case of *Franciscan Hotel v. Albuquerque Hotel Co.,* 24 P.2d 718 (New Mexico), involved a lease which was asked to be reformed. In answering an objection similar to that raised by plaintiff below, the Court pointed out that it is not necessary that there be a prior enforceable contract before reformation may be granted, only that there be a prior accord or meeting of the minds.

Such an accord has indisputably been shown to exist in the present case. The proof in this regard is subject to no other interpretation. Hence, under the applicable law, as reflected by the cases cited above, appellant was erroneously deprived by the Court below of the right to reform the instrument to make it speak in accord with the agreement between the parties. And as so reformed, it is apparent that the company has tendered full performance in complete fulfillment of its obligations under the contract.

The importance of this meeting of the minds concept in insurance cases is demonstrated by *Metropolitan Life Ins. Co. v. Banion,* 106 F.2d 561 (10th Cir.), a case from which the Court below quoted. Unfortunately, that quote did not reveal the most significant part of the holding, namely, that there was a meeting of the minds of the parties upon the terms set forth in the *policy.* The "contract" of insurance has an existence apart from any writings. The writings are only evidence of the contract. A policy which departs from the application can be a contract if there was a meeting of the minds on the provision embodied in the policy. The opposite is also true; the contract of insurance may in such a case be in accordance with the provisions embodied in the application, if it can be shown that there was a meeting of the minds on those provisions. Or the contract can be at variance with both the application and the policy. The important thing, after all, is the intent of the parties. In the *Banion* case, supra, the decision is replete with facts which clearly show that both parties had aban-

doned the application and had reached an accord on the addition of a double indemnity provision. For example, after insured had learned that he had passed the medical requirements and had been apprised of the cost of various policies, he wrote to the company stating that a check which included the additional cost of a double indemnity provision was enclosed. He had miscalculated the cost, however, so the company requested an additional check, which the company filled out itself. The company then reported to insured that this additional check added up to full payment for the policy, including the cost of the double indemnity coverage. In our case, however, the facts show just the reverse to be true. The insured asked for a 15 year rider. He at no time made request, formal or informal, for a 20 year rider. Another contrast with the *Banion* case is the fact that our insured paid the correct premium for the 15 year rider requested by the application. The intention of the insurer in the present case is equally well demonstrated. It becomes apparent that the meeting of the minds in the present case took place on the terms as they were contained in the application. The principle of the cited *Banion* case is controlling, although the result dictated by that principle is different in this case than in that one, because of the difference in the relevant facts.

If more argument be needed, a perfect example of the problems and the proper solution of the present case is provided by *Mutual Life Insurance Co. of N.Y. v. Simon,* 151 F. Supp. 408 (S.D.N.Y. 1957).

That case involved an insurance contract in which a scrivener's error was made in respect to the sum payable. The company sought to reform the policy to express the correct sum. There, as here, there was a preliminary question of conflict of laws to be resolved. There, as here, the policy had subsequently returned to the hands of the insurance company but the error had gone undetected until a time much later. There, as here, the insured sought to capitalize on an honest mistake of the insurer to enrich himself beyond that to which he was entitled. There, as here, the company wished only to perform the contract in full, and sought merely to avoid the windfall which the insured was attempting to collect at its expense. The parallel between the two cases is striking, extending even to the numerous obstructions thrown up by the insured in an attempt to prevent reformation. But the Court disposed of each obstruction and held squarely that the policy should be reformed to express the intention of the parties. A similar result is dictated here. It is the only proper application of the relevant law to the facts of this case. And it is the only just and equitable outcome of a case like the present one, giving each party his due, and no more.

V. APPELLANT'S DEFENSE OF MISTAKE IS LIKEWISE SHOWN AS A MATTER OF LAW.

Appellant's second contention is that under the applicable law, the type of mistake made here can be set up as a *defense* to the enforcement of the contract. This is making use of the mistake in a solely negative manner, using the fact of mistake as a shield. It does not at all involve the equitable right to reformation.

Authority for this type of relief is found in the New Mexico case of *Chaplin v. Korber Realty,* 224 Pac. 396 (New Mexico). In that case, a mistake had been made, and was attributable solely to the defendant. Plaintiff sued upon the contract and defendant set up the mistake as a defense. In allowing the defense, the Court observed as follows (p. 397):

> There is another consideration which precludes recovery by the appellant. The lower Court specifically found that to enforce the contract in question would be harsh, inequitable, contrary to fairness, and against good conscience, and would permit the appellant to gain an unfair advantage from the appellee's mistake of fact. * * * The granting or denial of the remedy is a matter of discretion which is controlled by the well-established doctrines of equitable jurisprudence. We may say generally that such relief will be granted when it appears from a view of all the facts and circumstances shown in a particular case that it will subserve the ends of justice, and for a like reason it will be withheld when it appears, from the same viewpoint, that to enforce it will result in hardship, injustice, or unfairness. If either of these would follow from grant-

ing such relief, it is the duty of a Court of equity to leave the parties to their remedies at law. And this is the rule whether the mistake be unilateral or mutual.

> "Unilateral mistake of defendants not caused or contributed to by plaintiff has frequently been admitted as a defense when to enforce the contract would be harsh and unreasonable." 36 Cyc. 605.

The present case presents a similar situation. Because of a mistake, plaintiff is seeking to impose a harsh and onerous burden upon appellant. This burden is one in excess of what was contracted for. *No consideration was given by the insured to compensate for this extra burden.* To permit plaintiff to succeed would be to permit her to take an unfair advantage over appellant for an innocent mistake. Plaintiff is not deserving of this windfall, nor is appellant deserving of this burden. Nor does the law countenance such opportunism, regardless of whether the mistake be classified as mutual or as unilateral. On the basis of the case cited above, and the well-known doctrine which it represents, appellant is entitled to a judgment. The Court below erred in disregarding this doctrine and giving judgment for plaintiff.

VI. DEFENDANT'S CAUSE OF ACTION FOR REFORMATION AND DEFENDANT'S DEFENSE OF MISTAKE ARE NOT BARRED BY THE STATUTE OF LIMITATIONS; FOR THE STATUTE DOES NOT BEGIN TO RUN UNTIL THERE HAS BEEN "DISCOVERY" OF THE FRAUD OR MISTAKE, AND THE FACTS IN THIS CASE DO NOT CONSTITUTE "DISCOVERY" ON THE PART OF THE DEFENDANT.

The applicable statute, California Code of Civil Procedure § 338(4), reads as follows:

> § 338. Three Years—Statutory Suit, Trespass, Trover, Fraud and Mistake.
>
> Within three years:
> An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake.

There is no contention made that defendant actually knew of the mistake until the time when plaintiff refused to accept the tender of final payment offered in good faith by defendant. The issue thus becomes whether or not on the basis of the proven facts, defendant can be deemed to have discovered the mistake, or, in other words, whether the defendant will be imputed with constructive knowledge of the mistake.

The facts on the basis of which such a constructive knowledge must be raised, if at all, are not in dispute. Defendant is an insurance company. It made out the policy which is here being sued on, and one of its employees inserted an incorrect figure in the written copy of the policy instead of the agreed upon figure. No carbon copy or other duplicate of this written copy was retained by defendant. (R. 177-178.)

This was in accord with its general practice of maintaining its records by use of the applications for insurance. (R. 177-178.) The written copy of the policy again came into defendant's hands at the time of insured's death. (R. 103.) The only purpose for the insurance company's having the written policy at that time was to stamp thereon its endorsement, which was to serve as a record for the beneficiary, to whom the written policy was then returned, that the policy had been processed for payment. At no other time was the written policy in the possession of defendant.

In ruling that these facts added up to constructive knowledge on the part of defendant, the Court below relied on the following proposition (R. 77):

> But under this section [C.C.P. § 338(4)], "It is well settled, of course, that the means of knowledge are the equivalent of knowledge."
>
> *Consolidated R. & P. Co. v. Scarborough,* 216 Cal. 698, 703-704, 16 P. 2d 268, 270.

It is not disputed that the means of knowledge were available to defendant in the sense that it could have earlier called for the policy to be sent in to it, or that it could have closely scrutinized the policy when it was in fact sent in at the time of insured's death. But this is not the sense in which the proposition above quoted is used. Its correct meaning is apparent from the decision actually made in the case, and from other language immediately following the quoted language.

The sentence quoted by the Court and the immediately following sentence read as follows (*Consolidated R. & P. Co. v. Scarborough,* 216 Cal. 698, 703-704, 16 P. 2d 268, 270, emphasis added):

> It is well settled, of course, that the means of knowledge are the equivalent of knowledge. (Citing cases). As stated in the case last above cited, "*where a party has knowledge of facts of a character which would reasonably put him upon inquiry,* and such inquiry, if pursued, would have led to a discovery of the fraud or other ground for rescission, he will be charged with having discovered the fraud or other ground as of the time he should have discovered it, that is, as of the time when he would have discovered it if he had with reasonable diligence pursued the inquiry when he should have done so."

The precise holding of the Court in the *Scarborough* case, *supra,* also sheds light on this subject. Plaintiff had appealed from a judgment sustaining defendant's demurrer. The Appellate Court held that the judgment was proper, in that plaintiff's complaint was lacking one vital allegation. That deficiency was an allegation showing the times and circumstances under which the facts constituting the fraud came to plaintiff's knowledge. The reason such an allegation is required is so the Court can determine whether those same circumstances were available at an earlier time. For instance, in the *Scarborough* case, the fraud came to light because an investigation was conducted. But why, asked the Court, was an investigation instigated. And why was it not instigated earlier. Such facts should affirmatively appear in the complaint.

As applied to the present case, this holding militates against constructive knowledge. For in the present case, the mistake came to light only when plaintiff refused to accept the final payment. This was the circumstance which caused the mistake to come to light, and of necessity, this circumstance, i.e., plaintiff's refusal, could not have occurred before it did. There were no facts other than plaintiff's refusal that might have put defendant on inquiry. There were no suspicious circumstances and no known facts, which demanded that an investigation be made, and which, if followed up, would have disclosed the mistake.

The law is certainly in accord with the ideas developed above and opposed to the proposition of the lower Court that "the means of knowledge are the equivalent of knowledge." The weight of authority and especially that authority of recent date is clear that to charge a person with knowledge when there was no actual knowledge, there must be a duty on that person to investigate plus negligence on the part of that person in fulfilling his duty. But absent such a duty, the presence of means of knowledge has no legal effect.

A short but complete statement of the law in this regard is found in *Schaefer v. Berinstein,* 140 Cal. App. 2d 278, 294-95, 295 P. 2d 113, 124:

> "The fact that an investigation would have revealed the falsity of the misrepresentations will not alone bar recovery. (Citing cases). The statute commences to run only after one has notice of circumstances sufficient to make a reasonably pru-

> dent person suspicious of fraud, thus putting him on inquiry. 'Where no duty is imposed by law upon a person to make inquiry, and where under the circumstances "a prudent man" would not be put upon inquiry, the mere fact that means of knowledge are open to a plaintiff, and he has not availed himself of them, does not debar him from relief when thereafter he shall make actual discovery. The circumstances must be such that the inquiry becomes a duty, and the failure to make it a negligent omission.' (*Tarke v. Bingham,* 123 Cal. 163, 166.) In many cases it has been said that means of knowledge are equivalent to knowledge. This is true only where there is a duty to inquire, as where plaintiff is aware of facts which would make a reasonably prudent person suspicious. (Citing cases.)"

See also *Hobart v. Hobart Estate Co.,* 26 C. 2d 412, 159 P. 2d 958; *Soule v. Bacon,* 150 Cal. 495, 89 Pac. 324; *Hallett v. Slaughter,* 22 C. 2d 552, 140 P. 2d 3. The question then becomes simply whether or not defendant insurance company had any duty to investigate the terms inserted in the written copy of the insurance policy, and if so, whether any of the company's acts or omissions in the handling of this policy add up to negligence, and if so, whether that negligence is enough under the circumstances to bar defendant from any relief.

There were no suspicious circumstances in this case which should have caused the defendant to call in the policy for inspection. And it would be extreme indeed to impose on insurance companies a general obligation to do so. The defendant's method of maintaining its

files, by the use of the signed applications rather than by use of carbon copies of the written insurance policies, is a sound and prudent business practice.

In addition, the precise issue raised here was raised on identical facts and decided adversely to plaintiff's contentions in the case of *Mutual Life Insurance Co. of N. Y. v. Simon,* 151 F. Supp. 408 (S.D.N.Y. 1957). The Court found that a scrivener's mistake had been made in copying certain terms from the application to the policy. The mistake was not caught by the insurance company upon the proofreading of the policy. The mistake was not caught when the policy later came again into the hands of the insurance company for various modifications. When the error was finally detected, many years later, the insurance company sued for reformation, and the insured countered with the defense of statute of limitations, but the federal District Court, *applying California law,* ruled that none of these events were sufficient to start the statute of limitations running. The mere fact that the policy was in the hands of the insurance company did not give the company actual knowledge of the mistake nor charge it with constructive knowledge. The *Simon* case is controlling of the legal significance of the identical facts present in this case.

Thus there is no evidence in the record sufficient to support the lower Court's finding that defendant insurance company received constructive knowledge of this mistake in 1939 and in 1945. Rather, it is demonstrated that there were no facts known to defendant, no suspicions entertained by defendant, and no

obligations upon defendant which would cause it to become apprised of the mistake set out here any earlier than the time when it actually did learn of the mistake, namely when plaintiff refused to accept the tender of final payment made by the company.

VII. IN ADDITION, THE APPLICABLE STATUTE OF LIMITATIONS DOES NOT APPLY WHEN FRAUD OR MISTAKE ARE RAISED AS A DEFENSE AND NO AFFIRMATIVE RELIEF IS SOUGHT THEREBY.

The latest ruling of the California Courts stands squarely for this proposition. That is the case of *Bank of America v. Vannini,* 140 Cal. App. 2d 120, 295 P. 2d 102, where the defense of fraud was interposed to a suit on a written contract. Fraud was raised both as a defense to plaintiff's cause of action and as a cross-complaint seeking damages for the defendant. The cross-complaint was held to be barred by the statute of limitations. But as to the defense of fraud, which did not involve affirmative relief, the Court ruled as follows (p. 127):

> . . . as stated in 1 Witkin, California Procedure, page 601, it is settled that the statute of limitations "runs only against a cause of action. If the answer pleads purely defensive matter, i.e., something which constitutes a defense to plaintiff's claim without calling for any affirmative relief, this defensive relief will not be barred by limitations. This is so even though the defensive matter could have been used as the basis of a cause of action for affirmative relief, and the statute has run on any such cause of action; it may still be used defensively. This principle is

chiefly applied where the plaintiff sues on a contract, and the defendant denies any liability on the obligation on grounds of fraud. . . ."

So here, mistake is set up both by way of defense to plaintiff's suit on the contract, and by way of counterclaim for reformation of the contract. The former is defensive relief, not affirmative relief. Whether or not the statute has run on the counterclaim for reformation, it should be held inapplicable to matter raised solely as a defense.

CONCLUSION.

For the reasons stated it is respectfully submitted that the judgment of the District Court should be reversed. In addition, the Court should direct that a judgment be entered granting reformation of the contract, as sought in defendant's conuterclaim. In any even, and failing a complete reversal, the portion of the judgment respecting those installments not yet due and owing should be reversed.

Dated, San Francisco, California,
November 29, 1957.

Respectfully submitted,
HENRY C. CLAUSEN,
KEESLING & KEESLING,
WILLIAM H. KEESLING,
Attorneys for Appellant
John Hancock Mutual Life
Insurance Company.